- Technical rules governing television station mergers—*e.g.*, relying upon stations' grade A or B contours—provide no insight into the competitive conditions in the markets within which those stations operate and compete. Such rules, therefore, are poor substitutes for an antitrust approach in serving the Commission's competition objectives.

- For example, there is sufficient information from a variety of sources upon which to conclude that the product dimension of relevant markets for local advertising messages may well encompass all media—including both electronic media, *e.g.*, radio, broadcast and cable television, and nonelectronic media, *e.g.*, direct mail, newspapers, magazines, yellow pages and billboards. Obviously, no technical rule can capture this complexity.

- The Commission's diversity objectives may be better served directly with subsidization rather than with ownership restrictions.

We have relied upon several sources of information. These include trade and professional literature as well as academic and government publications pertaining to competition in advertising and video delivery markets. We have also drawn upon the techniques and principles of microeconomic theory and industrial organization economics, as well as our own practical experience in analyzing the competitive effects of mergers, acquisitions and other trade practices within the context of antitrust proceedings and investigations generally, and within media markets in particular.

Our report is organized as follows: Section I contains a brief review of the Commission's stated objectives and its current and proposed Duopoly Rule. In Section II, we describe the economic foundation underlying the Commission's competition objectives—*i.e.*, we discuss the conditions under which limits on mergers and acquisitions promote competition and how this, in turn, would benefit the public. In Section III, we move from the general to the specific by describing the antitrust approach to evaluating television station acquisitions. Section IV contains several simple (hypothetical) illustrations of this approach and a discussion of the contradictions between antitrust analysis and the FCC's use of technical boundaries. In Section V, we briefly discuss the economic underpinnings of the Commission's diversity objectives. Our conclusions are summarized in Section VI.

I. BACKGROUND

A. The FCC's Stated Objectives

The FCC's mandate has been to promote the public interest through, at least in part, regulation of broadcast television. It historically has pursued this goal by promulgating regulations that are intended: (1) to promote diversity; and (2) to promote competition.

The Commission's diversity objective derives from the same concept that underlies the First Amendment—*i.e.*, "...the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public...."[2] The Commission has attempted to foster three types of diversity: viewpoint, outlet and source.

- *Viewpoint* diversity refers to the range of opinions that have access to and are broadcast over the airwaves.
- *Outlet* diversity refers to the number of separately owned stations or other services that deliver video programming that serve any given community.
- *Source* diversity refers to the variety of program producers and owners.

The FCC traditionally has focused only on outlet diversity by assuming that an increase or decrease in the number of separately owned outlets would result in a corresponding change in the range of viewpoints transmitted over the airwaves. With the FNPRM, it asks for comment on whether, and to what extent, nonbroadcast media should be considered as substitutes for broadcast television in fulfilling its diversity objective.

The Commission's competition objective is relatively straightforward: Competition, as a general matter, promotes consumer welfare and the efficient use of resources. Consequently, the FCC has a policy of encouraging competition among broadcast television stations and, perhaps, among competing sellers of (local and national video) advertising time and competing video program producers and distributors.

B. The Current Duopoly Rule and Proposed Changes in the FNPRM

The current version of the Duopoly Rule was adopted in 1964. It prohibits common ownership of broadcast television stations whose Grade B signal contours overlap. For any given station, this rule effectively precluded common ownership with any other station whose signal reached within a 50 to 70 mile radius around its transmitter. In effect, the Commission used the

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2 *See*, for example, *Associated Press v. United States*, 326, U.S. 1, 20 (1945); cited in the FNPRM at p. 24.

technical boundaries of broadcast stations' signal strength as a proxy for the *competitive* overlap between stations and, in turn, for the competitive conditions existing in their service areas. The Commission apparently believed that both competition and diversity would be fostered merely by maintaining a greater rather than a lesser number of separately owned stations.

In the FNPRM, the FCC recognizes that recent changes in the marketplace may enable it to relax the Duopoly Rule. These changes include, for example, the increased penetration of cable television service, the introduction of competitively meaningful direct broadcast satellite providers (DBS), home satellite dish service (HSD), wireless cable providers (MMDS) and, in the future, video dialtone service (VDT). Given these changes, the FCC has proposed to modify the Duopoly Rule to prohibit common ownership if there is overlap between two stations' Grade A contours, encompassing only about a 30 to 45 mile radius around the stations' transmitters. If this proposed rule were adopted, the Commission would continue to use the technical service areas within which stations broadcast as a rigid, effectively *per se*, standard for determining the competitive effects of broadcast television station mergers.[3]

II. COMPETITION OBJECTIVES

A. Economic Foundation

The basic idea underlying merger policy—and, indeed much of antitrust policy—is that competition is beneficial. In any industry, when suppliers compete with one another, each strives to offer better products at lower prices than the others.[4] Customers benefit directly from this competition. The goal of antitrust policy is to preserve the vigor of competition.

Mergers between suppliers can lead to a lessening of competitive vigor. Consider the extreme case: If all of the suppliers of a particular product were to merge, there would no longer

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[3] Moreover, by definition, such rules cannot distinguish among markets containing different numbers of independently owned stations, *e.g.*, a merger of two stations with overlapping Grade A contours in a market containing 15 stations would be subject to exactly the same analysis as one in a market containing 3 stations. These rules also fail to give any consideration to entry conditions, *i.e.*, the ability of new broadcast stations to come into existence.

[4] Competition among buyers is also in the public interest; it benefits suppliers just as competition among sellers benefits customers. This provides the basis for policy designed to prevent so-called monopsony power.

be any competition at all for the sales of that product.[5] But, a merger does not need to reach this extreme to hinder competition appreciably. Even when it falls short of creating a monopoly, a merger can reduce the vigor of competition in two ways: (1) by enabling the supplier unilaterally to exercise market power; or (2) by increasing the likelihood of successful anticompetitive coordinated conduct among the remaining suppliers. We consider each, in turn.

First, a merger can create a firm so large and powerful that it unilaterally can affect the price and quantity available in the marketplace. If, for instance, the merged supplier controls much of the market's productive capacity, it may be able to raise its prices with impunity. Thus, even if the higher prices prompted its customers to try to switch suppliers, the other suppliers in the market would lack the capacity to serve them adequately. The ability to raise prices above competitive levels—the levels that would result from vigorous, unfettered competition—is referred to as *market power*. When a firm is sufficiently dominant that, by itself, it can impose such a price increase on the marketplace, that power is referred to as *unilateral* market power. Thus, one way that a merger could hinder competition is by creating a firm with substantial unilateral market power.

Another way that competition may be hindered is by making it easier for erstwhile competitors to *collude* or *coordinate* their actions, rather than to compete vigorously with one another. When firms tacitly or overtly agree to limit their competition, customers suffer. If a merger makes this type of behavior more likely, say by making it easier for firms to exchange information or to agree on prices, competition could be hindered. In effect, the merger could make it easier for a group of firms *jointly* to exercise market power. Thus, mergers can harm competition by creating substantial unilateral market power or by facilitating coordination and the joint exercise of such market power among suppliers.

B. Application: Mergers and Acquisitions

1. Market Definition and Market Power

It should be clear from the foregoing discussion that merger policy should concern itself with disallowing combinations that create undue market power and allowing those that do not. The basic inquiry can be reduced to this question: Will the merger at issue significantly enhance or maintain market power? The answer depends upon the constraints on a firm's market power that

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[5] Of course, the product itself may well need to compete with other *products*, which may be sold by other suppliers altogether.

might exist in the marketplace. Such constraints include the presence of alternative products or suppliers to whom customers readily can turn. That is, if the newly merged firm tried to raise the prices of its products, what could its customers do? They could switch to another supplier of the same product, or try to substitute some other product in place of the ones they had been using. The more easily they could do either, the less freedom the merged firm would have to raise prices, *i.e.*, the less would be its market power.

This leads to a workable definition of the term *relevant market.* The relevant market in which to analyze a merger is the set of suppliers (and their products) that serve to constrain the market power of the firm that will be created by the merger. This set of suppliers, between them, currently supply (or could very readily supply) all of the products that the merging firms' customers regard as acceptable substitutes, either singly or in the aggregate, to the products that they currently buy from the merging firms.

Thus, this market is *relevant* to the antitrust inquiry at hand precisely because it is the market within which the merged firm's market power has to be assessed and the effect on competition must be weighed. It is important to understand this, because firms participate in many markets. Imagine a merger between two firms based in Illinois. Each operates in several markets: there may be a local market, a regional market and a national one. But not all of these markets will be *relevant* markets for an antitrust inquiry. Rather, you have only reached the relevant market(s) when you satisfy the condition described above: that the customers in the market regard the suppliers in the market as providing all of the acceptable substitutes available to them. That is, no supplier is excluded who currently supplies, or could readily supply, any of the products that the customers regard as acceptable alternatives.[6]

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[6] We note that what matters in determining the relevant market is whether the *aggregate* volume of dollars that move to substitute products is sufficient to constrain competitive behavior of suppliers of those products. If so, those products all belong in the same relevant market, *regardless* of the existence of less price-sensitive customers in that market. Thus, what matters is not whether all customers switch all of their purchases but, instead, that enough move enough of their purchases to substitute products.

The market, so defined, is likely to include both relatively strong and weak substitutes. That is, it is likely to include (1) stronger substitutes: products identical (or nearly so) in form, function and use with the product(s) at issue, *i.e.*, those typically viewed by consumers as more or less completely interchangeable; and (2) weaker substitutes: products that typically are viewed only as partial alternatives, so long as, either singly or in the aggregate, the degree of substitutability is sufficient to constrain competitive behavior.

Based on the foregoing, it should be clear that the relevant market has multiple dimensions. First, it consists of all of the products that the merged firm's customers view as substitutes to its own. This is the *product dimension* of the relevant market. Second, the relevant market comprises all of the suppliers who currently supply (or readily could supply) these substitute products and who the customers would regard as acceptable sources of supply. The locations these suppliers could readily supply constitutes the *geographic dimension* of the relevant market.

Finally, an often-overlooked aspect is the *time dimension*. The antitrust review of proposed mergers is intrinsically forward-looking. The likely nature of the market in the future may be more important than its current state. Suppose, for example, that the proposed merger is between the leading makers of a particular drug. If a new and greatly improved alternative to their products is going to be commercially available within one year (but is not currently available), the relevant market in which to analyze this merger may well include the new as-yet-unavailable technology.

2. The DOJ/FTC *Guidelines*

Having defined the relevant market, the next step is to evaluate whether the merger will either create significant unilateral market power or make it easier for suppliers to coordinate their actions in that relevant market. High market shares within the relevant market are a necessary, but insufficient, condition for a firm or group of firms to have substantial market power. Of course, even if the market contains only a small number of firms, each possessing high market shares, competition between them may be so vigorous that none enjoys undue market power. Thus, market shares and concentration can be useful to screen mergers—*i.e.*, to see whether they are so unlikely to create market power that they can be allowed without further scrutiny.

The DOJ/FTC *Merger Guidelines* use market shares and concentration for just such a purpose. The approach embodied in the *Guidelines* uses Herfindahl-Hirschman Indexes of concentration (HHIs). The HHI is the sum of the squared market shares of the market's participants, which gives proportionately greater weight to suppliers with greater shares. In the extreme case of monopoly, it takes its maximum value of 10,000 and falls between zero and 10,000 for any other market structure. Based on the HHI of the relevant market in which the proposed merger would take place, the *Guidelines* identify three broad situations:

- "unconcentrated" markets with HHIs below 1,000, where mergers are presumed unlikely to have anticompetitive effects and ordinarily will be allowed without further scrutiny.

- "moderately concentrated" markets with HHIs between 1,000 and 1,800, where proposed mergers that would raise the HHI by less than 100 are presumed unlikely to have anticompetitive effects and ordinarily will be allowed.
- and, "highly concentrated" markets with HHIs over 1,800. Even here, mergers that would raise the HHI by less than 50 ordinarily will be allowed.

In situations in which a merger does not fall into these "safe harbors," further scrutiny will be necessary. Of course, additional investigation may well lead to the conclusion that the merger should be allowed because it is unlikely to cause competitive harm. Thus, the HHI-threshold safe harbors described above are merely designed to test whether further inquiry is even necessary. When those thresholds are exceeded, the investigation must then turn to competitive conditions within the relevant markets—*i.e.*, to all of the factors that could constrain any unilateral or coordinated attempt at exercising market power.

III. ANTITRUST APPROACH TO ASSESSING TELEVISION STATION ACQUISITIONS

A. Relevant Markets

The FCC recognizes that ownership of several broadcast stations may "...increase the likelihood of anticompetitive behavior if (a) the stations serve the same market, (b) the market is concentrated, *i.e.*, has few competitors, and (c) allowing ownership of several broadcast stations substantially increases concentration in the market." [FNPRM, pp. 46-47.] Thus, the Commission acknowledges that the *economic* aspects of the market(s) within which broadcast stations compete affect the likelihood that any given merger would run afoul of the FCC's competition objectives. For reasons that we discuss below, it is unlikely that these markets, and the competitive conditions therein, would bear any resemblance to the technical areas within which the stations' broadcast signals happen to reach. Therefore, technical rules cannot capture the *competitive* overlap between broadcast television stations.

1. Advertising, Program Production and Delivery

In the FNPRM, the Commission has proposed to examine three separate relevant markets: advertising, video program production and video program delivery. While it is conceptually possible that local broadcast stations compete in each of these areas, it is the advertising market that clearly drives their competitive behavior. Stations earn income *only* from advertising sales. All advertising media create a product—an audience—which is marketed to advertisers. The production and delivery of video programming, whether news or entertainment, are only the means by which stations "produce" an audience that they, in turn, "sell" to advertisers. In this respect, the various media are no different from other firms who assemble various inputs to create a product that is sold to their ultimate customers. These relationships are illustrated in Tab A.

Thus, broadcast television stations compete, as suppliers of advertising time, for the patronage of local, regional and national advertisers.[7] Potential advertisers often are interested in reaching an audience with particular demographics; to the extent that the viewers of the stations' programming match those desired demographics, the advertiser will at least consider purchasing advertising time from the stations. The advertising rates charged, for example, by a local television station depend upon the characteristics of the audience it attracts—*e.g.*, audience size, age and income. Indeed, the rates ultimately charged by the stations depend, among other things, on the following factors:

- their relative bargaining power versus that of the advertiser;
- the attractiveness of their programming vis-a-vis that available in similarly-situated time slots garnering an audience with similar demographics;
- the extent to which the stations' programming is expected to reach the prospective audience—*e.g.*, whether delivered by cable versus over-the-air UHF or VHF signals and taking into consideration both the audience share and the quality of the advertising medium received or purchased; and
- the availability of alternative advertising media.

As noted above, in addressing the question of competitive substitutability, what matters in media markets is competition at the margin. Here, this may be defined both in terms of the number of advertisers that switch to other media and the proportion of their advertising budgets that

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7 This time may be sold as individual 15-second, 30-second or 60-second commercial spots or in larger blocks (*e.g.*, for infomercials, sporting or political events).

is moved to other media in response to relative price changes. For example, the question is not whether advertisers' entire budgets are moved from broadcast television to radio in response to a relative price increase; if the proportion of advertisers' budgets that would shift to radio is sufficient to constrain the competitive behavior of the broadcast television stations vying for their business, then radio advertising should be included within the relevant market.

Thus, the appropriate relevant market for assessing the competitive effects of any proposed television station merger should be the market for local advertising—*i.e.*, including both local and national spot advertising. Little additional insights are likely to be gained from attempting to analyze separate markets for video program production and delivery since stations' interest in these activities is driven overwhelmingly by their participation in the advertising market.[8] The fundamental question, then, is: To what extent can other advertising media, singly or in the aggregate, be considered effective economic substitutes for advertising on local television broadcasts?

2. Intermedia Substitutability

The answer depends upon the cross-elasticities of demand between alternative advertising media within the relevant local market. To arrive at independent estimates of these cross-elasticities, one would require transaction-specific information for all media that potentially provide a competitive check on local broadcast television stations. For example, these data might include prices, length of spot or size of print ad offered for sale and the time or daypart in which the spot or print ad appeared. Based on our review to date, the data required to prepare statistical estimates of cross-elasticities of demand are not available. This is not surprising. We understand that most local spot advertising rates result from ongoing oral negotiations between individual sellers and buyers of advertising time; consequently, there generally are no records, other than invoices (held both by media participants and their advertiser-customers), that may reveal the actual transaction prices for local television advertising. In addition, we are not aware of any single television station that possesses information concerning transaction prices charged by other stations or other media.[9]

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[8] Of course, local broadcast television stations may compete with one another as *buyers* of various factors of production, including labor, equipment, video programming or other inputs to video programming. Given the large number of potential customers available to suppliers to these inputs, these factor markets are unlikely to be affected by changes in the Duopoly Rule and, therefore, are not addressed explicitly in this report.

[9] We have also contacted the American Association of Advertising Agencies (AAAA), the National Cable Television Association (NCTA), the National Association of Broadcasters (NAB), the Newspaper Association (continued...)

Even so, both direct and inferential information about substitutability of alternative media is available from a number of sources. Among these are: (1) the perceptions and behavior of sellers of local advertising, *e.g.*, garnered from their selling materials; (2) studies published in the academic and trade press (including discussions of buyer perceptions and behavior); and (3) rate and volume trends of various media.

a. Seller Perceptions

Clearly, the important question is the extent to which advertisers perceive alternative media as substitutes. These perceptions could be elicited directly—*e.g.*, from surveys or other techniques. However, they also can be inferred from sellers' behavior. Specifically, to what extent do sellers of each advertising medium strive to gain advertising income at the expense of other media? Such activity suggests that *sellers* believe that advertisers substitute among the various media.

It is easy to find evidence of such activity in local advertising markets. Local newspapers often attempt to increase their share of advertisers' budgets at the expense of any other medium that those advertisers use. They do this, for example, by publishing advertisements that target television advertisers. Samples of such advertisements are included as Tab B. Tab C shows the response of at least one television station to these advertisements: the station attempted to sell directly against newspapers, stressing its relative competitive advantages.

Yellow Pages publishers also monitor the extent to which advertisers use alternative media. For example, the Yellow Pages Publishers Association, in its *Yellow Pages, Industry Facts Booklet*, 1992-93 Edition, provided its members with profiles of the competitive strengths and weaknesses of rivals from other media—*i.e.*, television, radio, direct mail, magazines, outdoor and newspapers. Radio, as well, targets advertisers that use other media. For example, the Radio Advertising Bureau, in its *Radio Marketing Guide and Fact Book for Advertisers*, 1993-1994, includes charts that profile (1) radio's audience reach versus that of newspapers and television and (2) radio's prices, in cost per thousand, versus spot television, newspapers, direct mail, outdoor and magazines. These charts are included as Tabs D, E and F.

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[9](...continued)
of America, Cabletelevision Advertising Bureau, Advertising Research Foundation and the Association of National Advertisers, among others. The information obtained from them is discussed below.

The American Newspaper Publishers Association, in presentation materials apparently designed for newspaper sales personnel, suggests that its two greatest competitors are cable television and direct marketing; the former is capturing a greater share of newspaper readers' time and money, while the latter is capturing an increasing share of its advertisers' spending.[10] The Newspaper Advertising Bureau, in its manual entitled *How to Estimate the Size of the Local Advertising Market and Your Share of It*, November 1989, suggests that newspapers explicitly consider radio, television, cable television and other media as direct competitors. Finally, the Television Bureau of Advertising has prepared various materials designed to enhance the ability of television stations to compete with other media. Examples are included in Tab G.

In sum, sellers of advertising obviously believe that their advertiser-customers view the alternative print and electronic media as substitutes for one another.[11]

b. The Literature on Substitutability

Within the academic literature, it has been widely recognized that various media do, in fact, compete for advertisers' dollars. For example, Owen and Wildman[12] state that:

> The television industry, broadcast as well as cable, competes for advertising with other media, notably radio broadcasting, newspapers, and magazines. ...most advertisers can substitute one medium for another in response to changes in prices of advertising time or space. Competition between television stations or networks and other media for advertising dollars may be nearly as fierce as competition among television outlets. (p. 14)

> There are a number of more or less good substitutes for network advertising: spot television advertising, advertising on basic cable networks and superstations, network and spot radio, national magazines, direct mail, billboards, and newspapers. (p. 154)

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10 David Cox, American Newspaper Publishers Association, *Who's the Competition—Really?*, a speech given to The International Marketing Association, May 22, 1990. See, for example, pp. 5-8.

11 This is also likely to be the case as well in the intermediate market for audience creation (not discussed here) within which broadcast television competes with these media for the attention of viewers and listeners and, in addition, competes with nonadvertiser supported entities, *e.g.*, pay TV, videocassettes, noncommercial TV and radio stations.

12 Bruce M. Owen and Steven S. Wildman, Video Economics, Harvard University Press, Cambridge, MA: 1992. See also, Sydney W. Head, Christopher H. Sterling and Lemuel B. Schofield, Broadcasting in America: A Survey of Electronic Media, 7th Edition, Houghton Mifflin Company, Boston, MA: 1994. See, for example, pp. 231-234.

However, there are relatively few studies that quantify empirically cross-elasticities of demand or other measures of the degree of substitutability among different media.[13] The overall conclusion is that broadcast television faces a number of substitutes, including cable television, radio, newspapers, magazines and direct mail.

For example, Seldon and Jung[14] explicitly attempted to quantify elasticities of substitution among different advertising media. Seldon and Jung employ data on (1) total advertising expenditures for 1950 through 1987, provided by Robert Coen of McCann Erickson; and (2) cost indexes for 1960 through 1987 in television, radio, newspaper, magazines, farm and business publications, direct mail, outdoor media and miscellaneous other media. They aggregate these expenditures into four groups: broadcast (*e.g.*, radio and television), print (*e.g.*, newspapers and magazines), direct mail and all other media (*e.g.*, outdoor).

They find that all of the elasticities of substitution are positive, suggesting that "a given level of sales can be maintained by substituting advertising in other media for advertising in any particular media to varying degrees...." (p. 78) More specifically, they conclude that broadcast advertising and direct mail are fairly close substitutes, as are print advertising and direct mail. They conclude that broadcast and print advertising, while substitutes for one another, have a somewhat smaller estimated elasticity of substitution.

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13 These studies include, for example: Richard Schmalensee, The Economics of Advertising, North-Holland Publishing Co., Amsterdam: 1972; Michael O. Wirth and Bruce T. Allen, "Another Look at Crossmedia Ownership," *The Antitrust Bulletin*, Spring 1979, 87-103; and Gary M. Fournier and Donald L. Martin, "Does Government-Restricted Entry Produce Market Power?: New Evidence from the Market for Television Advertising," *The Bell Journal of Economics*, Spring 1983, Vol. 14, No. 1 pp. 44-56.

Fournier and Martin found that stations may compete in broader markets that include perhaps wider geographic areas and other types of media and that focusing on broadcast stations alone overlooks some additional constraints placed on stations (p. 53).

14 Barry J. Seldon and Chulho Jung, "Derived Demand for Advertising Messages and Substitutability Among the Media," *The Quarterly Review of Economics and Finance*, Vol. 33, No. 1, Spring 1993, 71-86.

c. Rate and Volume Trends

It is widely recognized that advertisers' expenditures with newspapers have declined over time, while those on television, particularly cable television, have increased.[15] A number of factors may explain these trends including steady increases in television viewing hours per household, reductions in newspaper circulation over time and increases in the number of available television channels.

As the academic studies described above suggest, among the explanations for these trends may be a change in the relative price of advertising on television versus print media. To explore this possibility, we compared, as an example, the realized rate per thousand homes reached for 1990 through 1993 for the five largest television stations in one given Designated Market Area ("DMA") (Cleveland),[16] with the local newspaper's (*The Plain Dealer*) milline rate.[17] While these rates, measured as a cost per thousand, do not reflect the manner in which local television spots are

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[15] For example, Robert J. Coen of McCann Erickson reports (prepared for *Advertising Age*) that 1990-1994 annual growth in local and national advertising expenditures in newspapers rose 1.7 percent and remained constant, respectively. This may be compared with growth in advertising expenditures on four (4) television networks of 2.9 percent, syndicated TV of 11.8 percent, national spot of 2.9 percent, local spot of 4.1 percent, cable networks of 12.7 percent and local cable of 14.7 percent. These data indicate increased spending on television relative to print and, more strongly, increased spending on cable television. We do note, however, that the percentage growth of cable and syndicated television may be due, in part, to the relatively small initial level of expenditures on each.

For examples of the diversity of media used by advertisers and the relative shifts toward electronic media over time, see also, for example, (1) DDB Needham, *Media Trends 1993*; (2) Federal Communications Commission, "Broadcast Television in a Multichannel Marketplace," June 1991; (3) "Comments of the Staff of the Bureau of Economics of the Federal Trade Commission," September 24, 1992, Before the Federal Communications Commission, Washington, D.C., In the Matter of Review of the Commission's Regulations Governing Television Broadcasting, MM Docket No. 91-221, particularly pp. 15-18; (4) *Key Facts, 1991: Newspapers, Advertising and Marketing*, Newspaper Advertising Bureau, Inc.; (5) Albert E. Gollin, *An Assessment of Trends in U.S. Newspaper Circulation and Readership*, Newspaper Advertising Bureau, Inc., December 1991; and (6) *Media Week*: "Fast Moves for Fast Foods," January 11, 1993; "Sneaker Peek," February 1, 1993; "That's Entertainment," April 5, 1993; "The Road to Upfront: Food for Thought," May 10, 1993; "The Road to Upfront: Beverages," May 17, 1993; "The Road to Upfront: Automotive," May 31, 1993; "The Kids Krunch," July 5, 1993; and "The Numbers Add Up," September 27, 1993.

[16] We calculated the realized television spot rate per thousand homes reached as the total spot revenue earned by the five major television stations in the Cleveland DMA divided by their total households reached. (See Tab H.)

[17] The milline rate equals the newspaper's open daily or Sunday rate card rate per column inch, as published by Standard Rate & Data Service in *Newspaper Rates and Data*, divided by the newspaper's daily or Sunday circulation, in thousands. (See Tab H.)

bought and sold,[18] these data provide a rough view of the relative movement of television advertising rates versus those for newspapers.

The results of this comparison are presented in Tab H. We find that while expenditures on broadcast television have increased it has, in fact, also become less expensive relative to newspapers. This is consistent with the conclusion that lower advertising rates may, at least in part, account for the general shift away from print and toward electronic media. Again, the various media appear to be substitutes for one another.

B. Market Power and Likely Competitive Effects

1. Indicia of Market Power

Once the relevant market(s) have been defined, the likelihood of anticompetitive effects resulting from a merger may be assessed. This analysis typically begins with an evaluation of market concentration including, if possible, determining whether predicted changes in the HHI might allow a proposed merger to go unchallenged by invoking the DOJ/FTC safe harbors.

2. Nature of Competition

As discussed above, a large share of the market is a necessary but not sufficient condition for the exercise of meaningful market power. To the extent the market definition has included all appropriate substitute media, these factors are likely to be reflected in each seller's market share.[19]

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[18] The ratings and demographics associated with individual time-slots play an important role in setting television spot advertising rates but are not considered explicitly here.

[19] In this connection, UHF television stations historically have been at a competitive disadvantage vis-a-vis their VHF rivals. UHF stations have generally reached a lower number of homes and, accordingly, obtained a smaller share of viewers. This resulted directly from UHF stations' relatively weaker broadcast signal strength and typically led to lower UHF station revenue and profitability versus those for VHF stations. This disadvantage has decreased with the growth of cable television—*i.e.*, greater than 60 percent of DMA television households subscribe at least to basic cable service.

However, the UHF competitive disadvantage has not been eliminated. For one thing, on average, nearly 40 percent of the available audience is still subject to the over-the-air UHF broadcast disadvantage. This is illustrated by, among other things, the typically lower circulation of UHF stations. This lower circulation may reflect the fact that VHF stations in most markets have traditionally been affiliated with the three major national networks (CBS, ABC and NBC) and, therefore, enjoyed relatively greater demand for their programming. To test for this possibility, we compared UHF network affiliates with their VHF counterparts in those markets in which at least one network had a UHF affiliate. As shown in Tabs I and J, for channels with network affiliations, we find that household shares for UHF stations are routinely much lower than those for VHF stations.

(continued...)

Apart from quantitative share measures, a qualitative understanding of competitive conditions plays a role in determining whether a television station owner is likely to have post-merger market power. Such conditions could include, among others, (1) the extent of competitive overlap between the merging stations—*e.g.*, in terms of the audiences they deliver to advertisers;[20] (2) the way in which prices or other terms of sale are determined—*e.g.*, negotiated versus published price lists; and (3) whether there exist any other constraints on the unilateral or coordinated exercise of market power.

Even if we consider a hypothetical market limited only to local spot advertising on broadcast television,[21] certain television station mergers may *not* have anticompetitive effects, even

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19(...continued)

In addition, a recent Economists, Incorporated study, prepared in connection with MM Docket No. 94-123, found a persistent UHF handicap for affiliates of ABC, NBC and CBS. This report also found that the UHF disadvantage may have been substantially reduced (if not eliminated entirely) for non-affiliated UHF stations. ["An Economic Analysis of the Prime Time Access Rule," March 7, 1995, p. 84.] In connection with the same proceeding, the Law and Economics Consulting Group, Inc. found that the economic gap between UHF and VHF stations widened during the 1980s, a period in which cable grew rapidly. ["The Economic Effects of Repealing the Prime Time Access Rule: Impact on Broadcasting Markets and the Syndicated Program Market," prepared for Association of Independent Television Stations, Inc., King World Productions, Inc. and Viacom, Inc., March 7, 1995, pp. 32-44.]

20 For example, if a station operates on the fringes of a DMA, the advertisers it serves may well encompass an area different from the DMA. Thus, the relevant geographic market within which to assess any merger involving this station should be determined, in large part, by its competitive overlap with its proposed merger partner.

21 For purposes of this discussion, we exclude from consideration (1) the anticipated future growth of video dial tones provided by the nation's telephone companies; and (2) the presence and growing importance of cable television and broadband video services provided by, for example (a) wireless cable, (b) DBS (recently launched by, for example, DirecTv) due, among other things, to the marked reduction in receiving dish size, and (c) low-power television. In particular, cable television's increased use of and improvements in interconnects, as well as its increasing penetration and share will only enhance its competitive position vis-a-vis broadcast television.

We also exclude from this discussion the increasing availability, diversity and use of on-line information networks—*e.g.*, available from Prodigy, America Online, Compuserve or via direct access to the Internet/World Wide Web. This information is, of course, received for viewing via CRTs, which are much the same as television monitors. In fact, consumers may purchase software and hardware that enables them to use these services while, at the same time, viewing "traditional" television programming on the same screen.

We note that the Bureau of Economics of the Federal Trade Commission, in comments before the Federal Communications Commission [filed September 24, 1992; MM Docket No. 91-221] recognized the increasing variety of competitive media and the increased importance of cable television:

(continued...)

if there is significant overlap in their broadcast signal contours. For instance, local spot rates are determined in bilateral negotiations between individual television stations and both existing and prospective advertisers. This substantially reduces the likelihood of anticompetitive conduct. The agreed-upon negotiated rate will depend upon a number of factors, including the availability of alternatives and the relative bargaining power of the parties.

Indeed, the price-setting process for local television advertising is highly desegregated and advertisers have the ability to turn quickly, at a minimum, to other television stations within any given DMA.[22] This substantially reduces, if not eliminates entirely, the ability of any station or group of stations to impose noncompetitive terms and conditions of sale on their advertiser-customers. In addition, advertisers routinely play off one station against another in negotiating for better rates.

3. Likely Competitive Effects

The final step in an antitrust approach to evaluating proposed mergers is to determine the likely competitive effects of the combination. This requires that the responsible agency: (1) determine the relevant market within which to assess the proposed merger; (2) determine whether the proposed merger falls within specified safe harbors and, if it does not, (3) weigh the stations' market shares and any competitive conditions that might constrain their post-merger exercise of meaningful market power. This antitrust approach would determine whether the merger of any two television stations would promote (or retard) competition.

21(...continued)

"The [Notice of Proposed Rule Making] describes the recent substantial growth in the variety of communications sources available to consumers. These include not only broadcast and cable television, but also wireless cable, low-power television, home satellite receivers, video and audio recordings, and, soon, direct satellite audio and video services with digital audio. The NPRM notes that this multiplicity of sources poses a substantial competitive challenge to television broadcasters in seeking viewers." [pp. 5-6]

22 The mere threat of turning to other stations may be sufficient, in some instances, to constrain a station's competitive behavior.

IV. SIMPLE ILLUSTRATIONS

A. Approach

A few hypothetical examples are enough to reveal that the FCC's current and proposed technical rules cannot substitute for antitrust analysis of any proposed television station merger and, therefore, cannot fulfill the Commission's competition objective. To illustrate this, we examined hypothetical merger possibilities in 10 DMAs. These DMAs were ranked 1st, 11th, 21st, and so on, up to the 91st, based on 1995 television households in each.

Within each of these DMAs, we examined existing broadcast station Grade B and Grade A contours and identified (1) stations that would not be permitted to merge under the current and proposed rules; and (2) combinations of stations that would be merger candidates under the Commission's proposed Grade A rule. The results are presented in Tab K: In these DMAs, we found only three potential combinations, all in New York, that would be allowed under the existing rule and only relatively few possible combinations that would pass under the proposed rule.

Would antitrust analysis lead to similarly sweeping restrictions on proposed mergers? As we show below, the answer is no. Many mergers that are prohibited under the FCC's technical rules would be likely to pass muster under traditional antitrust analysis. Moreover, the technical rules cannot even distinguish between mergers that would be more likely or less likely to have anticompetitive effects.

B. Analysis of Market Shares

As discussed above, the appropriate relevant markets for assessing local television station mergers are the markets for local advertising. In the analysis of any actual merger, we would want to evaluate market shares based on each participant's local advertising revenue—*i.e.*, this would include each participating broadcast television station, local cable system, radio stations, newspapers and other competing media.

For our analysis of hypothetical mergers, however, such advertising revenue data were not available. Instead, *and purely for illustrative purposes*, we make two assumptions that are almost certainly both wrong and unduly restrictive: (1) we ignore competition between television (cable and broadcast) and other advertising media; and, (2) we assume that audience shares are a reasonable proxy for broadcast and cable stations' relative success in local advertising markets (since each "sells" its audience to local advertisers).

It is important to recognize that these "market shares" will be likely to *overstate* the true market shares of the participants in any properly defined relevant market, since we have omitted shares for other competing media—*e.g.*, newspapers, direct mail and radio. We have done this to show that, even with shares that significantly overstate true market shares, many mergers disallowed by the technical rules would be likely to pass muster under an antitrust test.

C. Application of DOJ/FTC Safe Harbors

Tab L sets forth the calculations of Herfindahl Indexes (HHIs) based on these audience shares.[23] Note that as the shares themselves are overstated (since they exclude important components of the advertising market), the HHIs will be even more so because they are calculated based on squared shares.[24] Even with these greatly overstated HHIs, it is clear that *some* potential acquisitions that would be precluded under the FCC's *ad hoc* technical rules would fall into the *Guidelines'* safe harbors. Indeed, in each of the DMAs considered, some combination of non-affiliated UHF stations would pass muster under the *Guidelines*, even based only on inflated market shares such as those presented here.

But, the story does not end there. In New York or New Orleans, for example, a combination of a network-affiliated station with some unaffiliated UHF stations may also not trigger scrutiny under the *Guidelines*. The extent to which this type of merger would be allowed would depend upon the case at hand. The merger of two VHF stations, or two affiliates generally, would be unlikely to fall into a safe harbor based on the numbers presented here. However, if shares (and HHIs) are based, as they should be, on advertising revenues in an appropriately defined relevant market, many of these mergers would be likely to pass muster under the *Guidelines* screens. And

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23 For purposes of our calculations, we have included the audience shares of PBS stations, inasmuch as they compete for audience attention, hence determining the size of the audience that can be sold to advertisers by commercial stations. In addition, individual PBS programs often are underwritten—with on-air attribution—by local and/or national business; these businesses provide both matching donations and in-kind premiums during the stations' fund drives.

We note also that audience shares for cable may, at least at present, overstate its share of local advertising revenue. Nevertheless, given the orders of magnitude involved, our conclusions are unlikely to be affected.

24 For instance, if TV advertising amounts to only half of local advertising expenditures, all shares will be overstated by a factor of 2 (assuming that audience shares, in fact, are reasonable proxies for advertising revenue shares, which is itself questionable). The HHI of the true relevant market, however, will be only one-fourth the HHI calculated based on the audience shares.

if they did not, of course, further antitrust scrutiny may or may not lead to a challenge depending upon the facts of the specific case.

D. *Ad hoc* Technical Rules Cannot Substitute for Analysis

Our analysis of a few stylized hypothetical markets suggests that technical rules cannot possibly capture the *competitive* conditions in any true relevant market. If the FCC truly wants to promote competition among television stations then only an antitrust approach to evaluating proposed mergers can accomplish this end.

V. DIVERSITY

As discussed above, in addition to its goal of promoting competition, the Commission also has an explicit objective of promoting diversity. The role of economics in evaluating the Duopoly Rule in this regard may be limited. Even so, two points are worth noting: First, the notion that more separately owned stations leads to more diversity could well be wrong. Consider a monopolist that owns all of the channels in a given area. It could well maximize profits by offering a broad range of programming, thus appealing to every audience niche. Here, greater concentration of ownership may actually promote diversity.[25] In contrast, consider areas in which there are a relatively large number of competing stations: each might maximize its profits by choosing programming to attract the median viewer.[26] In that case, diversity might be minimized. Which of these two outcomes hold would depend upon many things, including the number of stations in the market, viewer behavior, the relative sizes of different viewer groups and the extent of program costs.[27] In any event, one cannot predict with any degree of certainty whether an increase (decrease) in the number of independently owned stations will increase (decrease) diversity. Thus,

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25 The Commission recognizes this alternative school of thought. (*See* FNPRM, p. 28.)

26 The Commission refers to this school of thought as the "51 stations provide more diversity than 50" approach. (*See*, FNPRM, p. 27.)

27 Peter Steiner developed a model (1952) illustrating that monopoly ownership may yield greater diversity than would competition. This result depended upon a number of assumed conditions in the market, including those outlined in the text. Jack Beebe developed a simulation model (1977) that relaxed some of Steiner's assumptions and showed that the optimal amount of concentration is, in fact, indeterminate—*i.e.*, it depends upon a number of assumptions about available channel capacity, viewer preferences and audience distribution. [*See*, for example, Bruce M. Owen and Steven S. Wildman, Video Economics, Harvard University Press, Cambridge, Massachusetts, 1992, Chapter 3 (pp. 64-100).]

restrictions on television station ownership, such as the Duopoly Rule, are unlikely to be the best tool for promoting the Commission's diversity objectives.

How, then, could these objectives better be served? The answer could well be direct subsidization. Economic principles tell us that, in certain markets, there may exist so-called social or external benefits—*i.e.*, *externalities*, that accrue to the public but which competing firms, acting only in their self-interest, would undersupply. Diverse programming possibly constitutes precisely this type of social benefit. If so, direct subsidies efficiently create incentives for suppliers to provide these benefits.

As a matter of economics, therefore, ownership restrictions are an inefficient tool for promoting diversity. That is, (1) as the concentration-diversity debate illustrates, such restrictions are not *directly* related to stations' interests in providing diverse programming; and (2) the potential social harm—*e.g.*, in the form of maintaining more than the efficient number of independently owned stations—may, in fact, overwhelm any social benefits of diversity that might result from the ownership restrictions. Accordingly, the Commission's diversity objectives are likely to be better served by direct subsidization rather than with the Duopoly Rule.

VI. CONCLUSIONS

The antitrust approach to evaluating mergers is well-developed and is applied to a broad range of markets. The markets within which television stations compete are not so different from other markets that this approach cannot be applied successfully. Accordingly, while the markets in which broadcast television stations compete have their own specific characteristics, given the current and likely future nature of those markets, rigid technical rules covering mergers and acquisitions therein are unlikely to be helpful. In other words, to whatever extent the use of technical boundaries to evaluate competition among broadcast television stations may have been useful in the past, given the current and likely future nature of the relevant markets in which these stations compete, the competitiveness of such markets will be assessed and preserved more effectively by applying the tools of modern antitrust law and economics.

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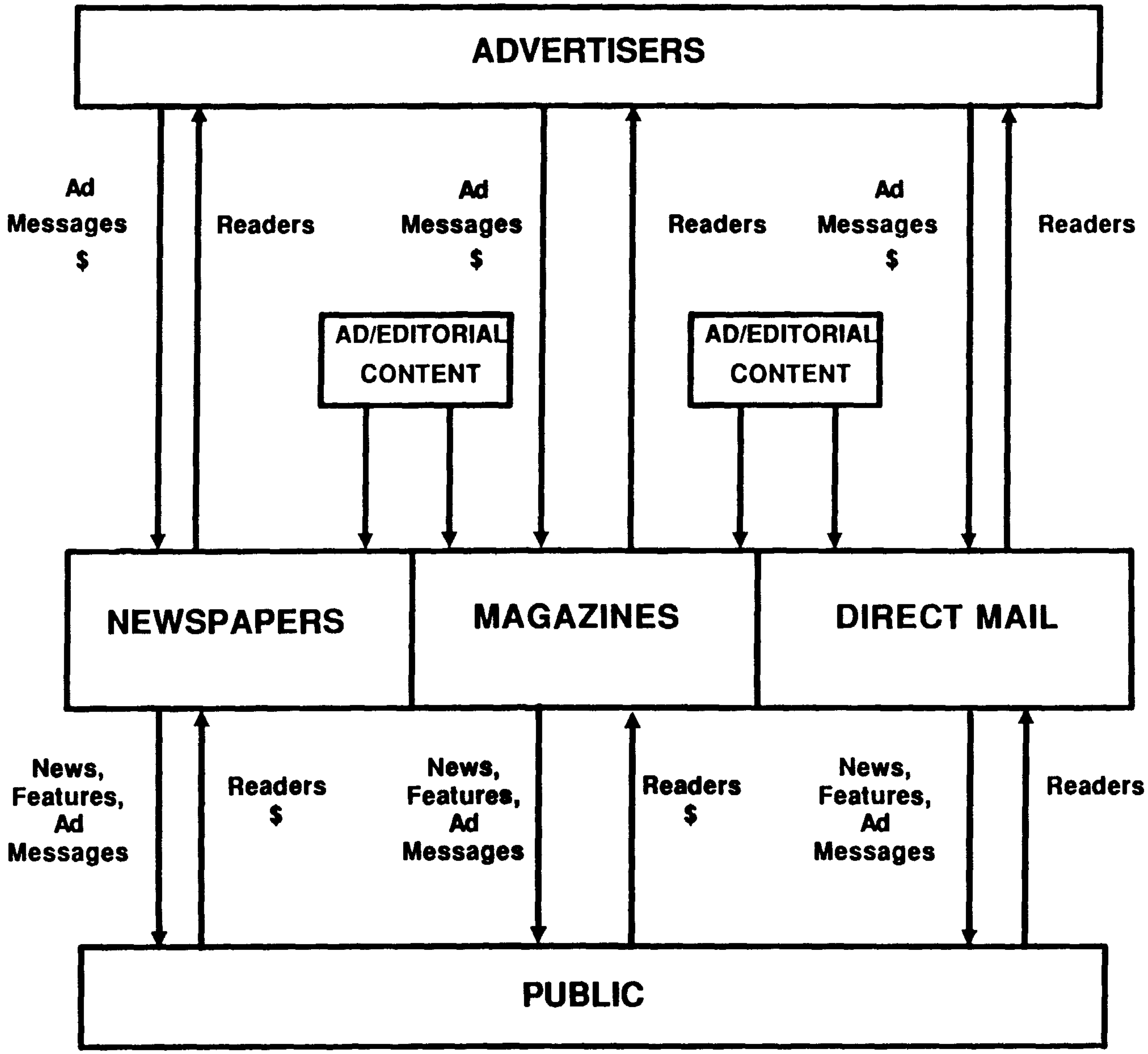
Producer	
↓	creates
Product	
↓	distributed by
Retailers	
↓	purchased by
Consumers	

So with Media, News, Information and Entertainment are the raw materials used to begin the audience creation process leading to ultimate purchase by advertisers.

News/Information/Entertainment	
↓	purchased/ packaged by
Media	
↓	creates
Audience	
↓	distributed by
Media	
↓	purchased by
Advertisers	

Print Media supply an audience to advertisers through ad/editorial content.



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